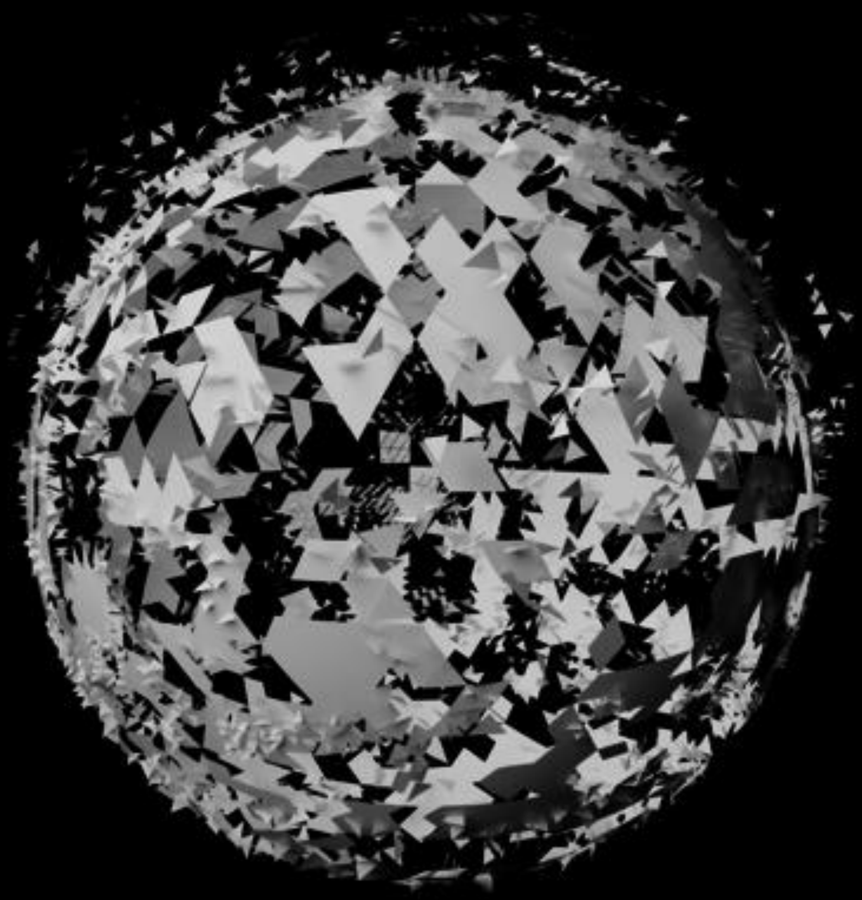

Basel IV
challenges and implications

Dimitrios Goranitis, Deloitte

CRD V and CRR II banking package | conditional timeline

2019

CRR2
- Scope, Supervisory powers
- TLAC requirements
- Provisions on massive disposals
- Own funds requirements for CCP exposures

31.12.2019
CRR2
- Commissions to adopt **Delegated Act modifying FRTB framework**

2020

One year after adoption of Delegated Act on FRTB
CRR2
- Application of FRTB reporting requirements based on Standardised Approach

18 months after entry into force CRD5/BRRD2
- **Member State adoption and publication and application deadline**

2021

2 years after entry into force CRR2
general application date

Including NSFR, SA-CCR, Leverage Ratio

CRR2
- Exemption from reductions of prudently valued software assets*

CRD5
- Provisions on interest rate risk arising from nontrading book activities

2022

01.01.2022
CRD5
- Restrictions and required actions in event of failure to meet capital/leverage ratio buffer requirements

CRR2
- G-SIB leverage ratio requirements equal to 50% of G-SIB buffer
- Restrictions and required actions in event of failure to meet capital/leverage ratio buffer requirements

Three years after date of entry into force
CRD5
- Requirement for two or more institutions, which are part of the same third country group to have a single Intermediate Parent Undertaking (IPU)

2023

Theree years after adoption of Delegated Act on FRTB
CRR2
- Application of FRTB reporting requirements based on Standardised Approach

Basel IV
Changing regulatory landscape

Substantial changes to all Basel Pillars force banks to reassess their business models and strategy in the attempt to secure a viable and sustainable future.

Pillar I

New standardised approach for credit risk	Revision of the use of internal models (IRB)	New Framework for Market Risk (FRTB)
New standardised approach for measuring counterparty credit risk	Revisions to the securitisation framework	Standardised Measurement Approach (SMA) for Operational Risk
Consultation on capital floors (impending)	Review of the CVA Risk Framework	Review of the Leverage Framework

Review of problematic loans and forbearance

Pillar II

By introducing the new SREP guideline, the EBA is changing Pillar II requirements significantly

The degree of freedom for measuring all risk types is reduced tremendously while institutions must simultaneously cope with changing Pillar I requirements

Interest Rate Risk in the Banking Book (IRRBB)

Pillar III

BCBS Disclosure requirements (Phase 1 and 2)

Impact on: Capital Planning, Business Model, Profitability Management

final

new or significant changes since December 2015

Upcoming regulatory changes

Key Changes

Revision to Credit Risk Standardised approach (SA)

- Risk weights of exposures secured by real estate based on loan-to-value diversification
- Separate risk weights for investment property
- Diversification based on external ratings, that requires appropriate due diligence process to determine risk weight
- Minimal Credit Conversion Factor (CCF) of 10% for all exposures

Fewer portofolios will be eligible for the Internal Rating-based approach (IRB)

- A-IRB is withdrawn for exposures to banks; financial institutions; large corporates; and equites
- For high-volatility commercial real estate, slotting is used. For all other specialized lending portofolios, slotting, F-IRB and A-IRB can be used
- Internal Model Approach (IMA) for CVA is withdrawn

Greater use of floors for IRB Parameters

- Output floor based on 72.5% of standardized risk weights
- Probability of default (PD) floor increases to 5bps from 3bps
- Unsecured loss given default (LGD) floor of 25% for corporates; 50% for qualifying residential real estate exposure (QRRE) exposures
- Secured LGD floors imposed, varying by collateral type

More restrictions on model approaches for IRB portfolios

- Double default approach is withdrawn
- More granular insights need to be given regarding the calculation of the risk-weighted assets under internally modelled and standardized approaches

Upcoming regulatory changes

Other main changes

	CRD IV / CRR	CRD V/ CRR II	Basel IV
	Current	2Q2021	?
Credit risk	STA IRB	STA IRB	STA IRB
Counterparty credit risk	MtM method OE method STA Internal models	STA Simplified STA OE method Internal models	STA Simplified STA OE method Internal models
Operational risk	BIA STA AMA	BIA STA AMA	BIA STA AMA
Market risk	Position risk FX risk Commodities Internal models	Position risk FX risk Commodities Internal models	Position risk FX risk Commodities Internal models
CVA	STA Advanced	STA Advanced	STA Advanced
Liquidity	LCR NSFR	LCR NSFR	LCR NSFR
Other	Leverage Own funds Pillar 3	Leverage Own funds Pillar 3	Leverage Own funds Pillar 3

changes

changes

No changes

Insignificant changes

Significant changes

Confront Basel IV requirements proactively

Revision of capital plan is needed

Regulatory capital is increasing	How you can offset?	
Credit Risk Standardized Approach RW for exposures to MDBs, institutions, corporates, default, equity, secured by mortgages on immovable property, high LTV, exposures denominated in foreign currencies CCF assignment, Credit Risk Mitigation Techniques.	✓ Good Internal Models ✓ Improve data quality; ✓ Increase RWA accuracy ✓ Reduce capital deductions and buffers	▸ **Business model viable and sustainable** (Collateral optimization, Product optimization, Review pricing) on long term. ▸ **Balance sheet optimization** under new regulatory framework (Exit unprofitable portfolios, Reduce limits, Capital allocation to high returns) considering how profits might evolve over time.
Credit Risk IRB Approach Remove the IRB approach Banks and other financial institutions, Large corporates and Equities Parameters floor, RWA floor.		
Operational Risk New Standardized Approach Changes in Business Indicator: Interest, Lease and Dividend Component, Services Component, Financial Component; Changes in Loss Component; High impact for banks applying AMA.		▸ **Timely assess new regulations** impact, adopt processes, prepare policies and procedures to meet the new requirements.
Market Risk FRTB Review New standardised approach, more complex than the current method, capital requirements dependent on models sensitivities for market risk factors, calculating and reporting capital requirements on a per-desk basis. Elimination of IMA-CVA		▸ **Start evaluating implementation options** considering increased complexity and needed processes changes.

Confront Basel IV requirements proactively

Potential implications for Banks

CORE/NON-CORE SPLIT

Banks may want to reassess their core/non-core split as certain portfolios may become more attractive from a capital perspective (e.g. lower rated securitisations and certain derivatives).

BUSINESS MIX AND ALLOCATION

Depending on where standardised floors and leverage ratio 'bite', capital allocation and pricing may need to change. This may lead to business mix change. (ex. OTC derivatives desks may need to switch to shorter dated products with more regular collateral exchanges).

CONTROLS

The significant increase in new data requirements that need to be sourced and related reporting requires significant data quality and controls enhancements.

INTERNAL MODEL USAGE

Banks currently in process of applying for model permissions or further extending existing model permissions to new portfolios will need to consider their model investments budgets, and timings for changes given potential reductions in benefits.

DATA AND IT

- Banks will need to put in place the necessary change and IT programs to cope with the new changes, many of which will require *whole new calculations* to be implemented and *new data supplies* to be sourced.
- FRTB changes (e.g. to account for diverse liquidity horizons, stress calibration and restricted asset class diversification) necessitate a large increase in the number of simulations required for the internal model approach with resulting impact on hardware requirements.
- The revised securitization approach will require a greater volume of data to be obtained on underlying portfolios.
- The BCBS 239 document presents a set of principles to strengthen the bank's risk data aggregation capabilities and risk reporting practices with a set of rules that applies both to G-SIBs and supervisors.

Confront Basel IV requirements proactively

Build it right!

- Set and maintain a culture of compliance,
- Establish clear roles and responsibilities
- Determine defined governance and management compliance risk committees
- Establish and maintain library of applicable regulatory requirements and/or guidance

- Map defined laws and regulations to applicable line of business and shared service functions
- Establish common risk language, definitions and tolerance levels.
- Develop methodology to prioritize and identify-high risk compliance areas of focus.
- Align the risk assessment program with the other components of the compliance program.

- Develop and maintain formalized regulatory compliance risk policies, procedures, and related controls documentation
- Establish and socialize business operating principles
- Anchor policies, procedures, and related controls documentation to regulatory guidance, as appropriate

- Establish scope and frequency for monitoring and testing based on compliance risk assessment results
- Develop compliance testing and monitoring schedule
- Perform periodic testing and monitoring of compliance controls
- Measure and monitoring corrective action or remediation plans(e.g., mandatory action plans and regulatory findings)

- Identify reporting requirements, develop dashboards and KPI
- Provide ongoing and periodic reporting to senior management and board, regulators, and internal audit
- Establish compliance communication plan and frequency for critical messaging

- Develop detailed business requirements
- Identify and document critical technology platforms leveraged by compliance
- Evaluate technology platforms and leverage existing infrastructure where possible
- Seek and utilize automation where possible for risk assessment, testing, reporting, and issue management

- Maintain enterprise-wide view of recent and planned examination activities and findings
- Determine communication protocols with the regulators
- Establish a standard process to receive and respond to regulatory inquiries
- Identify critical stakeholders within the first and second line of defense to engage during regulatory discussion